

OFFICE OF THE CITY AUDITOR PERFORMANCE AUDIT

December 2017

Arterial Street Impact Fee Ordinance Should Be Amended to Correct Structural Imbalance



CITY OF
KANSAS CITY,
MISSOURI

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HEART OF THE NATION



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December 11, 2017

Honorable Mayor and Members of the City Council:

The City Auditor's Office conducted this audit of the arterial street impact fee ordinance because the City Plan Commission expressed concerns that the fees produced by the current ordinance were not keeping pace with development in the city.


This audit focused on whether the city would benefit from increasing arterial street impact fees in accordance with Chapter 39 of the Code of Ordinances. Because raising fees alone will not eliminate the structural imbalance created by the arterial street impact fee ordinance, the ordinance needs to be modified.

Arterial street impact fees and methods for calculating related construction credits have contributed to the program's structural imbalance. In 2001, the arterial street impact fee ordinance discounted the impact fees to 50 percent of the city-hired consultant's maximum fees. Fees have not changed since the ordinance became effective in 2002 although construction costs have increased 58 percent through 2016.

The calculation of construction credits and their use to pay fees have also contributed to the structural imbalance. Credits are calculated using current total costs but discounted, 2002 fees. Developers currently hold \$13 million in arterial street impact credits. That amount would increase to \$21 million if fees were adjusted.

We make recommendations to modify Chapter 39 of the Code of Ordinances to make the arterial street impact fee program sustainable.

The draft report was made available to the mayor and the director of city planning and development on November 3, 2017, for review and comment. Their responses are appended. We would like to thank Land Development Division staff and other stakeholders for their assistance and cooperation during this audit. The audit team for this project was Joyce Patton and Nancy Hunt.


Douglas Jones
City Auditor

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Introduction

Objectives

We conducted this audit of arterial street impact fees under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit provides "findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability."¹

This report is designed to answer the following question:

- Would the city benefit from increasing the arterial street impact fees in accordance with Chapter 39 of the Code of Ordinances?

Scope and Methodology

Our review focuses on arterial street² impact fees. Our audit methods included:

- Reviewing Chapter 39 of the Code of Ordinances to identify the current impact fees and when fees were changed last.
- Reviewing the city-hired consultant's 2000 and 2001 impact fee studies to gain an understanding of arterial street impact fees.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2011), p. 17.

² According to Sec. 39-2 of the Code of Ordinances, an arterial street means all existing and planned city-maintained arterial streets, parkways, and boulevards identified in the city's adopted major street plan and M-9 from Parkville to Barry Road and M-291 from Liberty to I-435.

- Interviewing City Planning and Development employees to understand the impact fee payment and construction credit processes.
- Reviewing City Planning and Development's impact fee records to determine impact fee revenues and construction credits.
- Using the *Engineering News Record* Construction Cost Index to increase impact fees and construction credits to 2016 dollars.
- Interviewing stakeholders to obtain opinions on the impact fee program.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. No information was omitted from this report because it was deemed privileged or confidential.

Background

Impact Fees Established to Improve Equity

Before the passage of the city's arterial street impact fee ordinances in 2000 and 2001, the city required developers with frontage on arterial streets to construct the portion of the roadway adjacent to their project.³ This method led some developers to leave their arterial frontage undeveloped in order to avoid the costs associated with improving the arterial street.⁴ The method also resulted in constructing the arterial system incrementally,

³ We use the term "developer" to mean an individual or an organization whose activities make them subject to the arterial street impact fee ordinance.

⁴ Duncan and Associates, HNTB Taliaferro & Browne Cooper Consulting, "Arterial Street Impact Fee Phase One: North Service Area," September, 2000, p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," April, 2001, p.1.

producing a patchwork of improved and unimproved arterial street segments.⁵

The city hired a consultant in 1998 to conduct an impact fee study for development occurring north of the river.⁶ The scope of work was subsequently amended to include an impact fee study for development south of the river.⁷ The consultant issued the studies in 2000 and 2001 respectively. The purpose of the consultant studies was to establish standard fee structures that would be fair to all developers within a geographic area.⁸ Arterial street impact fees are based on a standard formula and a pre-determined fee schedule by land use type and/or size of the development.⁹ Impact fees require each new residential or commercial project to pay its formula-based share of the cost of new or expanded arterial street capacity needed to serve that development.¹⁰

Arterial street impact fees have advantages over the previous method.¹¹ Impact fees:

- Spread the costs of improving arterial streets to new development within specified arterial street impact fee benefit districts, treating developers with arterial frontage the same as developers without arterial frontage;
- Remove the incentive to leave arterial frontage undeveloped; and
- Act as a funding source for arterial improvements without waiting for development to occur immediately adjacent to the arterial street.¹²

Impact Fee Ordinance

When development occurs, traffic volume can increase and exceed the design capacity of the existing infrastructure. Chapter 39 of the Code of Ordinances is known as the arterial street impact fee

⁵ "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

⁶ Ordinance 980966, August 13, 1998.

⁷ Committee Substitute for Ordinance 000356, May 4, 2000.

⁸ "Arterial Street Impact Fee Phase One: North Service Area," pp.1 and 2; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

⁹ "Arterial Street Impact Fee Phase One: North Service Area," pp.1, 21, 22; and "Arterial Street Impact Fee Phase Two: South Service Area," pp.1, 18, 19.

¹⁰ "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

¹¹ "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

¹² "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

ordinance.¹³ This ordinance imposes a fee on new development proportionate with the costs the city will incur to provide arterial street facilities needed to serve the new development at the existing level of service for arterial streets.¹⁴

Rather than paying the fee, an arterial street impact fee obligation may be met by constructing an eligible improvement or using arterial street impact fee construction credits granted for prior construction or contributions.¹⁵

Eligible improvements for use of impact fees include the construction of new arterial streets, adding lanes to existing arterial streets, signalization, and intersection and other improvements to increase capacity of the arterial street.¹⁶ Improvements that only benefit the new development such as dedicated turn lanes are not an eligible improvement.¹⁷

The arterial street impact fee ordinance established five benefit districts (A thru E) north of the river and three benefit districts (F thru H) south of the river. (See Exhibit 1.) Certain areas of the city have been excluded from these benefit districts. Generally, the excluded areas are older, mostly developed areas, where the arterial roadway system is largely complete.¹⁸ The exclusion was also intended to encourage infill and redevelopment.¹⁹

¹³ Code of Ordinances, Kansas City, Missouri, Sec. 39-1(a).

¹⁴ Code of Ordinances, Sec. 39-2.

¹⁵ Code of Ordinances, Sec. 39-8(a). A contribution is providing a capital asset such as traffic signals.

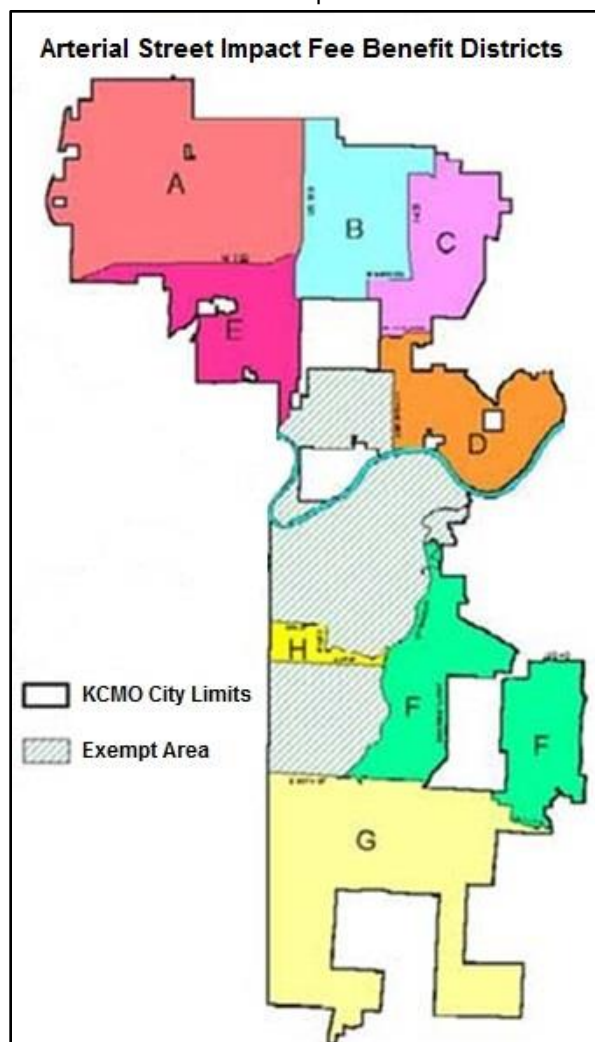
¹⁶ Code of Ordinances, Sec. 39-6(g).

¹⁷ Code of Ordinances, Sec. 39-8(a).

¹⁸ "Arterial Street Impact Fee Phase One: North Service Area," p.3; and "Arterial Street Impact Fee Phase Two: South Service Area," p.2.

¹⁹ "Arterial Street Impact Fee Phase One: North Service Area," p.3; and "Arterial Street Impact Fee Phase Two: South Service Area," p.2.

Exhibit 1. Arterial Street Impact Fee Benefit Districts.



Source: City Planning and Development.

Only new developments located within one of the benefit districts are obligated to pay the arterial street impact fee.²⁰ Impact fees collected are to be deposited in a trust account for the benefit district in which the fee was collected and used for arterial street improvements within the benefit district.²¹ Up to eight percent of the fees collected in a year can be transferred to the general fund to pay for program administration.²² A uniform percent of the fees collected in each benefit district during the last year may be used to cover consultant costs to update the arterial street impact fees.²³

²⁰ Code of Ordinances, Sec. 39-3(a).

²¹ Code of Ordinances, Sec. 39-6(f) and 39-6(g).

²² Code of Ordinances, Sec. 39-6(f).

²³ Code of Ordinances, Sec. 39-6(f).

City Planning and Development Manages Arterial Street Impact Fee Program

The arterial street impact fee program currently resides in the Land Development Division of the City Planning and Development Department. The division assesses arterial street impact fees for both residential and non-residential developments.²⁴ The impact fee administrator is the person or persons designated by the city to administer the arterial street impact fee ordinance.²⁵ The position is vacant. An acting administrator is handling the position responsibilities.

²⁴ Code of Ordinances, Sec. 39-4(b).

²⁵ Code of Ordinances, Sec. 39-2.

Findings and Recommendations

Ordinance Created Structurally Imbalanced Program

The fees produced by the arterial street impact fee ordinance are not sufficient to fund needed arterial street improvements. The program's structural imbalance is the result of provisions in the current ordinance. The arterial street impact fee ordinance discounted the impact fee to 50 percent of the city-hired consultant's maximum fee per unit of development. Although construction costs have increased by 58 percent since fees were established, the impact fee schedule has not been adjusted. We estimate current fees cover only about 32 percent of arterial street improvements needed to handle the additional traffic generated by new development.

The arterial street impact fee ordinance's methods for calculating construction credits also contribute to the impact fee program's structural imbalance. The ordinance granted construction credits for contributions, payments, bonds submitted securing completion of improvements, and construction accepted and received up to 25 years before the effective date of the ordinance. Construction credits are calculated based on 100 percent of the contribution, payment, or estimated cost of construction of the arterial street improvement and the uninflated, discounted 50 percent fee resulting in the granting of a growing number of construction credits. As of September 2017, developers held more than \$13 million in arterial street impact fee construction credits. Under the current ordinance, if fees were adjusted, the existing construction credits would grow to almost \$21 million.

The current impact fee ordinance needs to be modified. Increasing the fees alone will not correct all of the program's problems. Fees need to be increased in conjunction with or after other ordinance modifications are in place.

Discounted Fees Contribute to Structural Imbalance

The ordinances establishing the arterial street impact fees discounted the fee structure developed in the consultant's studies, resulting in a funding gap. The original impact fee ordinance, passed in 2000, called for developers to pay 75 percent of the

maximum impact fee recommended by the consultant.²⁶ A subsequent ordinance, passed in 2001, discounted the fee to its current 50 percent fee level, creating an even wider funding gap.²⁷

The impact fee ordinance was intended to impose a fee “in an amount based upon the amount of new arterial street demand attributable to new development and the cost of providing the additional arterial street facilities needed to serve that new development.”²⁸ The fees were designed to be “proportionate with the costs the city will incur to provide arterial street facilities needed to serve that new development at the existing level of service for arterial street facilities.”²⁹

In a February 2017 memorandum to the Mayor and City Council, the City Plan Commission identified the discounted fee structure as negatively impacting timely improvements and the quality of life for the community and recommended eliminating the discount.³⁰ Given the structural imbalance created by the impact fee ordinance, the City Plan Commission’s recommendation deserves consideration.

Inflation Contributes to Structural Imbalance

Arterial street impact fees have not been adjusted since they became effective in 2002.³¹ Construction costs increased 58 percent between 2002 and 2016.³² Based on the discounted fee structure and changes to the construction cost index through 2016, we estimate fees cover only about 32 percent of arterial street improvements needed to handle the additional traffic generated by new development. Section 39-10 of the arterial street impact fee ordinance requires that at least once every three years the city’s impact fee administrator recommend to the City Council whether any changes to the fee schedule should be made after analyzing the effects of inflation and to ensure fees do not exceed the pro rata share of the reasonably anticipated costs of facilities necessitated by new development.³³ No recommendations to adjust the fees for inflation have been made since the ordinance became effective in 2002.

²⁶ Third Committee Substitute for Ordinance 000083, October 19, 2000.

²⁷ Committee Substitute for Ordinance 011258 as Amended, September 27, 2001.

²⁸ Code of Ordinances, Sec. 39-1(b).

²⁹ Code of Ordinances, Sec. 39-2.

³⁰ Memorandum from the City Plan Commission to the Mayor and City Councilmembers, February 7, 2017.

³¹ Second Committee Substitute for Ordinance 051437 added fees for a Quick Lubrication Center land use in 2006. No other fees have been added or adjusted.

³² We calculated the increase in construction costs using the *Engineering News Record* Construction Cost Index identified in Sec. 39-8 of the Code of Ordinances.

³³ Code of Ordinances, Sec. 39-10.

Construction Credits Contribute to Structural Imbalance

Provisions in the Code of Ordinances related to construction credits have contributed to the current structural imbalance in the arterial street impact fee program. The calculation method set out in the ordinance for granting construction credits exacerbates the program's structural imbalance because the fees are discounted and have not been increased to reflect increases in construction costs. Increasing fees would result in an increase in the value of current construction credits to almost \$21 million. The code authorized credits for actions taken up to 25 years before the arterial street impact fee ordinance was effective. Over one half of the impact fees paid by developers between 2008 and 2017 were paid with construction credits. Paying arterial street impact fees with construction credits does not provide funds that could be used by the city to pay for arterial street improvements.

The discounted fee structure results in increased construction credits. The consultant studies viewed impact fees as a supplement, rather than a replacement for the prior method of funding for arterial street capacity expansion.³⁴ While developers could still choose to improve their arterial frontage, they would be given construction credits for the difference between the cost of the improvement and the impact fee.³⁵ The ordinance's use of the discounted fee structure in calculating construction credits, however, resulted in the granting of additional construction credits because costs were entered into the calculation at 100 percent while fees were discounted to 50 percent.

For example, assuming it cost a developer \$150,000 to improve the arterial street and the impact fee was \$100,000, the developer would have received a construction credit of \$50,000 based on the consultant's impact fees schedule. But because the arterial street impact fee ordinance discounted the consultant's impact fee schedule by 50 percent, the developer in the example above would have an impact fee of \$50,000 and would receive \$100,000 in construction credits because the impact fee was discounted. The discounted fee structure results in developers paying half as much in fees and receiving additional construction credits. (See Exhibit 2.)

³⁴ "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1.

³⁵ "Arterial Street Impact Fee Phase One: North Service Area," p.1; and "Arterial Street Impact Fee Phase Two: South Service Area," p.1; and Code of Ordinances, Sec. 39-8.

Arterial Street Impact Fee Ordinance Should Be Amended to Correct Structural Imbalance

Exhibit 2. Example: Effect of Discounted Fee Structure on Construction Credit Calculations

	Consultant-Developed Impact Fee	Ordinance-Adopted Impact Fee
Cost of Construction	\$150,000	\$150,000
Impact Fee	100,000	50,000
Construction Credits	\$ 50,000	\$100,000

Sources: Hypothetical example with City Auditor's Office calculations.

More construction credits have been issued than would have been issued if both the cost of construction and the fee used in the construction credit calculation were both at 100 percent.

Developers used construction credits to pay for almost \$7.8 million of impact fees from fiscal years 2008 thru 2017, representing 53 percent of impact fee payments during the period. (See Exhibit 3.)

Exhibit 3. Sources of Impact Fee Payments, Fiscal Years 2008 - 2017

Fiscal Year	Cash		Construction Credits	
	Amount	Percent	Amount	Percent
2008	\$1,050,648	43.2%	\$1,379,235	56.8%
2009	950,004	45.9%	1,118,177	54.1%
2010	450,661	58.6%	318,766	41.4%
2011	227,482	30.7%	512,529	69.3%
2012	169,795	31.1%	376,503	68.9%
2013	259,298	36.7%	447,021	63.3%
2014	884,445	45.8%	1,044,569	54.2%
2015	579,536	36.5%	1,006,716	63.5%
2016	978,908	51.7%	916,014	48.3%
2017	1,263,798	65.3%	672,516	34.7%
Total	\$6,814,575	46.7%	\$7,792,046	53.3%

Sources: PeopleSoft Financials, City Planning and Development Records, and City Auditor's Office Calculations.

The arterial street impact fee ordinance allows construction credits to be used by the original recipient or to be sold, traded, or transferred to others to pay for impact fees within the benefit district for which the construction credits were originally granted.³⁶ Using construction credits to pay for impact fees, as authorized by ordinance, could delay arterial street improvements needed by development since fees paid with construction credits do not provide funds needed to pay for necessary arterial street improvements.

The ordinance granting construction credits for prior work resulted in increased credits. The arterial street impact fee

³⁶ Code of Ordinances, Sec. 39-8(b)(5).

ordinance authorized the issuance of construction credits for arterial street contributions, payments, bonds submitted securing completion of improvements, or construction accepted and received up to 25 years *before* the ordinance became effective in 2002.³⁷ Issuing construction credits for arterial street improvements made between 1977 and 2002 increased the construction credits available to offset future impact fees.

Increasing construction costs result in more credits. The arterial street impact fee ordinance provides a method for adjusting the value of construction credits if the impact fee schedule is revised to account for inflation.³⁸ Using the ordinance methodology, construction costs increased 58 percent between 2002 and 2016 although the arterial street impact fees have never been increased, resulting in a growing number of credits.

For example, assuming it cost a developer \$150,000 to improve an arterial street in 2002 and the arterial street impact fee was \$50,000, the developer would receive \$100,000 in construction credits. But, because the construction costs have increased by 58 percent while the impact fees have remained unchanged, the construction credits issued would have grown to \$187,000 based on 2016 construction costs. (See Exhibit 4.)

Exhibit 4. Example: Effect of Increased Construction Costs and Unadjusted Fees on Construction Credits

	2002 Construction Costs	2016 Construction Costs
Construction Cost	\$150,000	\$237,000
Impact Fee	50,000	50,000
Construction Credits	\$100,000	\$187,000

Source: Hypothetical example with City Auditor's Office calculations.

Adjusting fees for inflation will result in more construction credits. Under the arterial street impact fee ordinance, if the city increased the arterial street impact fee schedules to account for inflation, the city would have to adjust existing construction credits.³⁹ As of September 2017, developers held over \$13 million in arterial street impact fee construction credits. Adjusting the fee schedule for inflation could increase the value of current

³⁷ Code of Ordinances, Sec. 39-8(a) and (b). The Third Committee Substitute for Ordinance 000083 as amended authorized credits for construction made no more than ten years prior to the effective date of Chapter 39. Committee Substitute for Ordinance 011258 as amended expanded the time frame to 25 years. According to Sec. 39-8(b)(2) of the Code of Ordinances, developers had to file applications by May 1, 2003 to receive credits for arterial street improvements they made from May 1, 1977 to May 1, 2002. If the credit application was denied, the developer had until August 1, 2006 to appeal the decision.

³⁸ Code of Ordinances, Sec. 39-8(b)(3) and (5).

³⁹ Code of Ordinances, Sec. 39-8(b)(3) and (5).

construction credits to almost \$21 million. Staff have not recommended a fee increase because of the significant increase in construction credits that would occur under the current ordinance provisions.

Ordinance Needs to Be Amended

The arterial street impact fee program established in the current impact fee ordinance is insufficient to fund necessary arterial street improvements and should be amended. The arterial street impact fee ordinance sets out the process for amending the ordinance.⁴⁰ The impact fee administrator recommends changes to the fee schedule to the City Council.⁴¹ The impact fee steering committee, appointed by the mayor, reviews any proposed changes including changes to the fee schedule, and makes recommendations to the City Council.⁴²

To begin addressing the arterial street impact fee program's structural imbalance, the mayor should appoint the impact fee steering committee.

The City Plan Commission's February 2017 memorandum to the mayor and City Council made a number of recommendations for potential changes that should be considered by the impact fee steering committee. During the course of this audit, we found that city staff who have been or are involved with the impact fee ordinance also have ideas for improving the sustainability of the arterial street impact fee ordinance.

The current arterial street impact fee ordinance results in needed arterial street improvements not being made. Ordinance adjustments that should be submitted to the steering committee for examination and recommendation include:

- Eliminating adjustments to credits for inflation,
- After eliminating adjustments to credits for inflation, eliminating the 50 percent discount on fees,
- After eliminating adjustments to credits for inflation, adjusting the current fee schedule to current dollar values using the record construction cost index published by *Engineering News*,
- Including additional land use types in the fee schedule,
- Permitting the impact fee administrator to submit fee increases directly for council approval as is done with other

⁴⁰ Code of Ordinances, Sec. 39-10.

⁴¹ Code of Ordinances, Sec. 39-10(a).

⁴² Code of Ordinances, Sec. 39-10(b).

city fees rather than requiring review and approval by the steering committee, and

- Evaluating whether to hire a consultant to update the 2000 and 2001 arterial street impact fee studies.

Arterial street impact fee construction credits and other issues should be reviewed and discussed with recommended actions addressed in a multi-step process. Eliminating adjustments to credits for inflation should be done before any other modifications to the ordinance in order to prevent further exacerbating the structural imbalance.

To strengthen the arterial street impact fee ordinance and begin addressing the program's structural imbalance for funding arterial street improvements, the director of city planning and development should provide a copy of the City Plan Commission's February 2017 memorandum, staff suggestions, and this audit to the impact fee steering committee so the committee can begin reviewing and recommending sustainable changes to the arterial street impact fee ordinance.

Recommendations

1. As outlined in the arterial street impact fee ordinance, the mayor should appoint the impact fee steering committee to review proposed changes to the arterial street impact fee ordinance.
2. The director of city planning and development should provide a copy of the City Plan Commission's February 2017 memorandum, staff suggestions, and this audit to the impact fee steering committee to begin reviewing and recommending sustainable changes to the arterial street impact fee ordinance.

Appendix A

Mayor's Response



Office of the Mayor

Mayor Sylvester "Sly" James, Jr.

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414 East 12th Street
Kansas City, Missouri 64106

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NOV 29 2017

CITY AUDITOR'S OFFICE

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To: Doug Jones, City Auditor
From: Mayor James *SJ*
Subject: Arterial Street Impact Fee Audit Response
Date: 11/27/2017

1. As outlined in the arterial street impact fee ordinance, the mayor should appoint the impact fee steering committee to review proposed changes to the arterial street impact fee ordinance.

Agree

I will appoint, per Sec. 39-10(b), an Arterial Street Impact Fee Steering Committee by January 15, 2018.

Arterial Street Impact Fee Ordinance Should Be Amended to Correct Structural Imbalance

Appendix B

Director of City Planning and Development's Response




City Planning and Development Department

Office of the Director

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414 East 12th Street
Kansas City, Missouri 64106-2795

(816) 513-1500
Fax (816) 513-2838

Date: November 29, 2017
To: Douglas Jones, City Auditor
From: Jeffrey Williams, AICP, City Planning and Development Director 
Subject: Response to Performance Audit: *Arterial Street Impact Fee Ordinance Should Be Amended to Correct Structural Imbalance*

- 2. The director of city planning and development should provide a copy of the City Plan Commission's February 2017 memorandum, staff suggestions, and this audit to the impact fee steering committee to begin reviewing and recommending sustainable changes to the arterial street impact fee ordinance.**

I am in agreement with the above recommended action. Our department will provide the indicated documents to the impact fee steering committee within one week of a committee member's appointment.

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cc: Troy M. Schulte, City Manager